

CHAPTER 7

LEASE DURATION, SUBLEASING AND LEASE RATES

7.1 PURPOSE

This Chapter provides an overview and analysis of key leasing policy issues (other than reversion, which is addressed in Chapter 6.) It addresses a number of questions related to leasing policy that the City has posed:

- What is an appropriate lease duration?
- How should sub-leasing be managed?
- How should lease rates be determined?

The focus of this Chapter is on the leasing of airport property for aeronautical purposes. With the exception of the Chamber of Commerce all current tenants and subtenants are aviation users. The consultants do not expect this to change on the airport itself. Both aviation and non-aviation related development, in addition to the Chamber of Commerce, may be possible along the narrow strip of Rainier Avenue South that was part of the original deed. However, the development potential for this area is limited due to geography and is unlikely to have a major impact on the airport.

7.2 CONCLUSIONS

- There need to be, and generally are at Renton, differences in basic lease durations for land vs. building sites. The duration for land leases is generally much longer than that for facility leases: 25-50 years instead of 3-5 years, to allow tenants to amortize their investments and make a reasonable profit.
- There are various options for lease terms, and for extension of land leases if that is in the public interest. Lease terms can be fixed for a specific number of years or tied to the level of investment and based on the required timeframe to amortize the investment.
- Depending on the type of lease of the primary tenants, (e.g. a commercial operator subleasing aircraft storage hangars, an aeronautical service provider subleasing space to another service provider with compatible services, or a private tenant of a City-operated hangar,) there should be different approaches to requiring permission for the subleasing agreement by the City.
- Airports generally permit aircraft storage subleases by commercial primary tenants without explicit permission by the airport. Commercial service subleases are generally approved if the prospective subtenant meets a set of criteria applied uniformly, e.g. financial viability, agreement to comply with minimum standards.

- The airport cannot reject subleases for storage of certain types of aircraft, e.g. jets, or require that subtenants sign “voluntary” agreements to comply with “voluntary” noise abatement measures at the airport as condition for approving a sublease without running afoul of FAA commitments.
- There are both federal and state laws requiring the airport to ensure that it receives fair market value for its land and/or facilities.

7.3 FINDINGS

The following provides the results of research into different approaches to determining the appropriate lease duration, subleasing arrangements, and lease rates.

7.3.1 Lease Duration

The first key area is *lease duration*. As Figure 6-1 in Chapter 6 indicated, in general, there are two major types of leases: Land leases that require significant capital investment and facility leases that do not. Both are addressed below.

7.3.1.1 Land Leases

The following focuses on the first type of lease, land or ground leases that require significant capital investment.

It is common for a lease for unimproved land at an airport to include a requirement that, within a certain time period, the operator must construct a specific, approved type of building to accommodate an approved list of services. This generally depends on what the airport may need at that time and on demand for airport land. So once the lease is signed, the new tenant must finalize architectural drawings, find a contractor, obtain permits, and more importantly, secure the needed financing.

The ability of prospective tenants to secure adequate funding is a critical issue that can impact the ability of an airport to attract good tenants and must be considered in any decision regarding lease duration. The National Air Transportation Association comments¹:

“Any potential lender will make his decision after an assessment of the financial return he can expect over the life of the loan as compared with other investment opportunities available to him. Thus, the amount loaned will be limited to that which can be adequately amortized from the funds generated by the business expected during the term of the lease.”

Opinions about the needed duration of a lease that is required in order to amortize a loan vary. This is because the amount of time required to recoup an investment is dependent on a number of different factors that vary from loan to loan and airport to airport. Factors include:

- The loan amount that will be required to construct and maintain the proposed improvement;
- The type of service that will be provided (e.g. it may take longer to recoup the investment on a condo T-hangar than a maintenance hangar used by an aeronautical business);
- The expected useful life of the building to be constructed;
- The amortization period for the building; and
- Activity mix, levels and projections at the airport, providing an indication of how much revenue the business can expect in the course of a year.

Airports across the country have therefore implemented leasing policies that provide a variety of lease duration options.

It should also be noted that, due to the more stringent code requirements imposed in recent years, buildings that are erected today are both more durable and more expensive to build. This means that prospective tenants today will likely require longer leases to secure funding, pay off the loan, and, in the case of FBOs, make a reasonable profit from the investment than tenants 30 or 40 years ago, when the buildings at Renton Airport that are now at the end of their initial lease term were constructed. A lease term of 25 years, which was suggested by tenants, may be appropriate because it is consistent with the time frame during which a building is typically depreciated for tax purposes.

One question being posed by the City is: should the city create shorter terms for ground leases as a means of increasing the rate at which building reversions will occur in the future? What are the pros and cons of such a strategy? As the above analysis indicates, if a ground lease tenant is to put up a building, commercial financing is almost always required. This means that a lease of 25-50 years is needed to assure the lender that the investment is sound. Thus, requiring shorter-term ground leases at the time of initial construction is not a productive approach to airport management. Leases can and should, however, be structured to allow for rate increases throughout their life, and to address other concerns such as the tenant paying for demolition and site remediation at the end of the building's useful life.

The most commonly used lease duration options are:

7.3.1.1.1 Fixed Duration

A fixed duration lease provides a lease for a specified number of years, e.g. 25 years, usually with an option to renew the lease for a fixed amount of time or number of times for a certain period of time, this is the approach currently used in Renton. It has the advantage of being simple, easy to understand, and consistent but may not provide enough incentive to make larger investments in service-oriented improvements that may

be needed at an airport. Different airports across the country use different lease terms, with 25-40 years (including all options for renewal) being the most common timeframe.

The nature of the buildings to be installed and their normal useful life before requiring major renovation also affect the loan amount and lease period required. Boeing indicates that, for its purposes, a lease of 50 years is a minimum for making building investments². Klamath Falls, OR provides tenants with a 30-year lease that can be extended by ten years. The State of Oregon approaches the matter in this way, saying³:

“Lease term: The Base Term for commercial⁴ leases will be no longer than twenty-five (25) years. If the lessee requests a renewal, ODA may agree to renew the lease, consistent with this section, for one five year period, or other period that, together with the period of the base term lease, does not exceed 30 years.”

7.3.1.1.2 Flexible Duration

Another approach is to set a standard duration, e.g. 25 years, but to allow for some flexibility and negotiation based on factors such as those listed above and the requirements of the bank providing the loan. Tenants under this approach would also be given options for extension, and there would be a maximum on the duration of leases. The City of Auburn has used this approach for its most recent leases. The city extended the lease period for its new tenants because its new tenants would otherwise not have been able to secure funding for the improvements they were planning to make. The recent ground leases given out by the City of Auburn cover a 50-year lease period. This approach has the advantage of providing room for negotiation if a desirable prospective tenant cannot secure funding for the proposed improvement if the standard lease period is applied. On the other hand, it may create an equity problem if different tenants with similar improvement costs receive different terms.

7.3.1.1.3 Graduated Duration Based on the Level of Investment

A third option is a lease term that is graduated in duration, based on the level of investment made, often with a maximum lease duration specified. For example, Salt Lake City has an investment schedule that links the duration of the lease to the level of investment provided by the tenant for its three airports. Each airport has a different schedule. Salt Lake City International Airport is a commercial airport, and its terms are shorter than the terms for the two general aviation airports to encourage development of (general aviation) facilities at these airports. Figure 7-1 illustrates the combined schedules.

Figure 7-1: 2000 Investment Schedules for Salt Lake City, UT Airports⁵

DOLLARS INVESTED	SALT LAKE CITY INTERNATIONAL AIRPORT TERMS	AIRPORT II TERMS	TOOELE VALLEY AIRPORT TERMS
\$180,000 - Minimum	15 years	16 years	17 years
\$180,000 – \$357,000	15 - 17.5 years	16 – 18.5 years	17 years – 19.5 years
\$357,000 - \$535,000	17.5 – 20 years	18.5 years – 21 years	19.5 years – 22 years
\$535,000 - \$714,000	20 years – 22.5 years	21 years – 23.5 years	22 years – 24.5 years
\$714,000 - \$1,041,250	22.5 – 25 years	23.5 years – 26 years	24.5 years – 27 years
\$1,041,250 - \$1,487,500	25 years – 27.5 years	26 years – 28.5 years	27 years – 29.5 years
\$1,487,500 – \$2,231,250	27.5 years – 30 years	28.5 years – 31 years	29.5 years – 32 years
\$2,231,250 - \$3,570,000	30 years – 32.5 years	31 years – 33.5 years	32 years – 34.5 years
\$3,570,000 - \$4,908,750	32.5 – 35 years	33.5 – 36 years	34.5 years- 37 years
\$4,908,750 - over	Negotiable	Negotiable	Negotiable

Source: Salt Lake City Department of Airports, 6.07.100 Investment/Term Policy.

The State of Alaska is currently proposing to grant leases at its rural airports in this fashion. According to the proposal, for a five-year lease, there is no investment requirement. A six-year lease requires an investment of at least \$7,500. After that, each one-year lease term extension requires an additional \$7,500 in investment. Using this approach a prospective tenant is granted a 20-year lease if he or she makes an \$112,500 investment. A prospective tenant who wishes to be granted the maximum lease term of 55 years must invest at least \$375,000⁶.

This approach has the advantage of rewarding those tenants who make larger investments and makes it easier for them to secure funding. On the other hand, this approach is the most complex of all options. It also does not address issues such as the size of the leasehold that would be improved. For example, an investment of \$1 million on a 1 acre leasehold has different implications and economics than the same investment on less than an acre.

7.3.1.1.4 Lease Extensions Based on Major Interim Investments

Salt Lake City has also made provisions for tenants who make improvements to existing facilities that do not add square footage but increase the structural integrity or facility market value. The city considers the additional investment toward an increased lease term on a decreasing scale. For improvements made during the first half of the existing lease term, 50 percent of the investment will be recognized and the lease term will be adjusted according to the investment/term schedule. Improvements made during the second half of the term are recognized at 25 percent of the new investment with corresponding lease term adjustment. The additional term will be averaged with the existing lease term for any lease extension. This approach gives tenants the incentive to make improvements to their premises during the course of the lease and thus provides the aviation community with facilities that are in better shape and more likely up to current standard than other approaches.

7.3.1.2 Facility Leases

Facility leases are granted for tie-downs for aircraft and for T-hangar and conventional hangar space both for the storage of aircraft and for the provision of aeronautical services. Since the tenant does not make a major investment, they can be for relatively short periods of time. Leases for aircraft tie-downs are usually on a month-to-month basis, leases for hangar space for aircraft storage are on a year-to-year basis. Both are generally automatically renewed unless the airport or the tenant cancels the lease. Under this arrangement, the tenant is typically required to carry out minimal maintenance.

Hangar space leased to aviation businesses for the provision of aircraft maintenance, fueling or other services follow a different approach. They may be for a period of 3-5 years and may or may not be renewable, depending on the performance of the lessee, perceived airport needs and other factors. After the lease period, the premises are offered in a competitive process and the previous tenant may again compete with other potential tenants for the premises. Under this arrangement, the tenant is generally required to carry out only minor maintenance. Hangar leases for City-owned facilities that require the tenant to make major improvements or maintenance efforts may be significantly longer than standard leases for service hangars.

7.3.2 Sub-Leasing

Subleases fall into four general types:

1. **Subleases for private aircraft storage:** Partial subleases that are inherent in the nature of the business being done (i.e., subleases from a prime tenant operating a row of T-hangars to individual private pilots for aircraft storage);
2. **Subleases for aeronautical service providers:** Subleases of portions of aeronautical facilities to other aviation businesses to provide a more complete set of aviation services;
3. **Subleases of entire commercial aeronautical facilities:** Subleases or assignments of an entire commercial aeronautical facility (generally to a successor in interest such as a merger partner or someone buying the business); and
4. **Subleases of City-operated aircraft storage:** Subleases or assignments of noncommercial city-operated space (such as a general aviation pilot “passing on” his T-hangar to an associate or friend when he removes his aircraft from the field).

No matter which type of the lease is under consideration for a subleasing arrangement, however, the City has an obligation to consider all sublease proposals in a fair and nondiscriminatory manner. For example, preventing tenants from subleasing aircraft storage hangar space to jet owners without a completed and FAA-approved Part 161 study, or because subtenants refuse to sign a contract requiring them to comply with voluntary noise measures and accept sanctions if they do not use the procedures, violates

the FAA's equal access requirement. Subleases for aeronautical service providers generally cannot reasonably be denied as long as the prospective subtenant is financially able to run the proposed business, meets the minimum standards in place for the type of service to be provided, and has no record of misconduct as defined by generally applied airport rules and regulations or environmental protection requirements.

Another issue related to subleasing is whether an airport should charge commercial tenants a portion of the revenue they generate from subleases. Both are addressed below.

7.3.2.1 Handling Requests For Subleases

The following outlines general practice in handling subleases for airport facilities for the four types of subleases listed above:

1. **Subleases for private aircraft storage:** Subleasing is necessary for commercial tenants leasing T-hangar bays or conventional hangar aircraft storage to aircraft owners. It should be allowed without additional approval by the City as long as both primary tenant and subtenant comply with all applicable rules and regulations in force at the airport. It is useful to include a clause in the primary lease that indicates that the primary tenant is responsible for any damage or environmental hazard caused by his/her subtenant.
2. **Subleases for aeronautical service providers:** They are generally appropriate, with written approval of the airport sponsor, if an aeronautical service provider or Fixed Base Operator on the airport wishes to sublease space to another business providing complementary services. Whether permitting subleasing is appropriate will also depend on the situation and the market. Aviation businesses typically operate with very small profit margins, and so if space is not needed for the tenant's own purposes, the ability to get approval for subleases can be critical to the operator's financial well-being. In addition, there are many small and specialized operators seeking an airport location that could not afford the development of a large facility and will always be in the market to sublease small amounts of space. This type of sublease is generally granted as long as the business subleasing space is financially able to do so and agrees to comply with the minimum standards that apply to the specific type of service to be provided and has obtained all relevant licenses and permits.
3. **Subleases of entire commercial aeronautical facilities:** They are generally appropriate, with written approval of the airport sponsor, if the entire leasehold is transferred to a merger partner or someone buying the business. This allows the airport to maintain the range of services that was previously available on the airport and maintain its attractiveness to other tenants. This type of sublease is therefore generally granted as long as the business subleasing space is financially able to do so and agrees to comply with the minimum standards that apply to the specific type of service to be provided and has obtained all relevant licenses and permits.

4. **Subleases of City-operated aircraft storage:** They are almost never appropriate for private tie-down and aircraft storage hangar leases for City-owned and managed property. Subleases of tie-downs or hangar space owned and operated for the City, for which there often are long waiting lists, should be allowed only under extenuating circumstances and for short periods of time.

Any sublease request that requires airport manager approval must generally be submitted in writing to the airport administration, and approval will, if granted, also be in writing. The only exception is commercial tenants leasing aircraft storage hangar space to private tenants. Where subleasing is permitted and written approvals are required, the City should respond promptly. FAA has held that in evaluating an airport's compliance status, unjustifiably long delays in responding to requests for required approvals are equivalent to denials of approval.

Most airports, as does Renton, acknowledge the need for aeronautical service providers to provide a range of services on site to be competitive and have additional language saying that if the proposed sublease of a commercial leasehold is for an approved activity, a sublease shall not be unreasonably withheld. Informal subleasing may occur and should not be permitted; and the lease document should contain sanctions against the prime tenant to minimize unauthorized subleases.

Renton currently has language governing subleases in most of its major commercial leases (this example is drawn from Pro-Flight Aviation Inc., LAG 99-002):

“Assignment/subletting: This lease or any part thereof shall not be assigned by Lessee, by operation of law or otherwise, nor shall the premises or any part thereof be sublet without the prior written consent of Lessor, which consent shall not be unreasonably withheld, subject to Lessor's receipt of commercially reasonable evidence that the proposed assignee or subtenant is in a financial condition to undertake the obligations of this lease and agrees to assume and be bound by all of the Lessee's obligations under this lease, to the same extent as if it were the original Lessee. If Lessee is a corporation, the transfer of a majority of Lessee's stock shall constitute an assignment for purposes of this paragraph.

Subletting: Lessee may sublet portions of the Premises to the public for the purpose of aircraft tie-down storage only without the prior written approval by the Lessor of this permitted use, on a month-to-month or longer basis (but not longer than the term of this Lease), provided that Lessor is informed on at least annual basis, in writing, the purpose of the sublease, the amount of the rental charged, of the name of the sublessee(s), and the type of aircraft stored (make, model and registration number). Such information shall be disclosed upon request by Lessor.

Subsequent Consent Required: In the event written consent to assignment or subletting shall be given by Lessor, no other subsequent assignment, assignments, or subletting shall be made by such assignee or assignees, without the prior written consent of the Lessor. It is expressly agreed that if consent is once given by the Lessor to the assignment of this lease or any interest therein or the subletting of the whole or any part of the premises, then Lessor shall not be barred from afterwards refusing to consent to any further assignment of said lease or subletting of said leased premises.”

Our interviews with airport tenants have indicated that the City’s approach to handling subleases for commercial tenants providing aeronautical services is an issue that needs the attention of the City. There appear to be commercial operations on the airport that operate without written subleases that are approved in writing by the City, and not all businesses have the operating permits that would be required if they were to apply for permission to operate on the airport today. This is a situation that can cause problems for the City and should be remedied.

7.3.2.2 Sharing Tenant Revenue From Subleases

The City has expressed interest in generating additional revenue from commercial tenants by requiring these tenants to share their revenue from subleases with their landlord. This approach is more common on commercial service airports than on general aviation airports, although some general aviation airports do use this approach.

For example, Las Cruces, NM charges all commercial tenants on the airport a “commercial license fee⁷.” The airport requires a 2% share of gross revenues from most commercial activities, including aircraft storage, fuel and pilot supply sales, and the airport’s restaurant. The fee for some on demand commercial flying services and the manufacture, repair or reconditioning of new or used aircraft and/or parts and the sale of aircraft and aircraft parts is one half percent of gross income. In addition, the airport charges on demand flying services with small aircraft (18,000 pounds or less) a \$200 per month “airport infrastructure maintenance fee.” This is because New Mexico’s statutes do not allow landing fees for aircraft weighing 18,000 pounds or less. Heavier aircraft are assessed landing fees. The airport does not collect a separate fuel flowage fee.

Some of the issues that must be addressed to determine whether it makes sense to require commercial tenants to share their revenue with the airport include:

- Can this requirement be added to existing leases or would it apply only to new leases?
- Is it possible to achieve consistency of charges to tenants? This is particularly important at an airport like Renton with one major tenant with a specialized aviation business.
- How much revenue can realistically be generated?

- Will the market bear an additional fee?
- Can the City manage the process of administering the fee that requires regular financial reports and audits?
- What is the cost of administration?

The advantage of this approach is that it can provide additional revenue to the City. On the other hand, the Fixed Base Operators on general aviation airports are often marginal businesses. Additional fees may have significant impact on the economic viability of these businesses, affecting the provision of services and thus the attractiveness of the airport for other (potential) tenants. In the case of Renton, a significant issue is also whether such a fee could or should be applied to Boeing, and whether it could be implemented in a nondiscriminatory fashion if Boeing were excluded from the provision.

7.3.3 Lease Rates

A number of principles guide the development, implementation and use of lease rates for airport property. FAA indicates that⁸:

- Rates and fees imposed on aeronautical users for the use of the airport must be fair and reasonable.
- Revenues from fees imposed on aeronautical users cannot exceed the costs of providing current airport facilities and services, including debt service, planning and environmental evaluation and clean-up.
- The methodology for determining rates and fees and adjusting them on a timely and predictable schedule must be reasonable, consistent, and transparent.
- Airport sponsors must maintain a fee and rental structure that makes the airport as financially self-sufficient as possible under the circumstances. If an airport is currently not self-sufficient, the airport sponsor is required to establish long-term goals and targets to work toward that goal.
- Airport sponsors should not seek to establish a rate and fee structure that creates a revenue surplus exceeding the funds required for airport purposes. Reasonable reserves and other funds to facilitate financing and cover contingencies are allowed.
- Airport revenues can only be used to meet the capital and operating costs of the airport.⁹

In addition, Washington's Constitution requires airports in the state to charge market rates to avoid the prohibition on providing funds, credit, or property to the private sector. Neither Washington State nor federal law prescribes the method to be used in

establishing appropriate lease rates. However, the requirements outlined above indicate that the methodology must:

- Provide for fairness and openness in the process;
- Establish a rate that addresses both the federal requirement for financial self-sufficiency and the state requirement for charging fair market value; and
- Do so at regular, timely, and predictable intervals.

Different airports are using different approaches to achieve this goal. For example, King County reappraises all leaseholds at Boeing Field every three years and adjusts lease rates accordingly¹⁰. This is an approach that makes sense for a larger airport with a fairly large number of tenants. For smaller airports with relatively small numbers of tenants, an appraisal every three years would be costly. In this case, a reappraisal every five years is appropriate, (potentially) with a provision to increase lease rates based on the local CPI in interim years. Auburn Municipal Airport uses this approach for its new leases. Longer-term adjustments that are based solely on the CPI are generally not recommended because the aviation industry does not track the CPI closely enough.

Until now, Renton has used the following approach:

Generally, lease rates are updated every three years based on the Consumer Price Index (CPI) for the Puget Sound region. In 1998, Renton Airport had an arbitration process to determine Fair Market Value for all the non-Boeing leaseholds. [Boeing's lease rates have always been arrived at through negotiation.] The City and the tenants each chose an appraiser and an independent panel reviewed the data that was developed. As a result, rates were set for all the various types of leasehold property, along with an escalator clause to address inflation. In the arbitration process, property values were examined for a number of other general aviation airports in the region, including Boeing Field.

7.3.4 Leasehold Specification

Some tenants have indicated that they are paying rent as part of their lease for public areas of the airport, such as taxiways and parking, that are not for their exclusive use. Other tenants do not pay for such areas. While it may be appropriate for the City to charge service fees for maintenance of these public areas, it should not charge rent for them.